

Message Text

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TO SECSTATE WASHDC 8591

INFO AMCONSUL HONG KONG

AMEMBASSY TAIPEI

AMEMBASSY TOKYO

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E.O. 11652: N/A

TAGS: ECON, EGEN, EARL, KS

SUBJ: ECONOMIC OUTLOOK FOR 1978

SUMMARY: 1978 APPEARS TO BE ANOTHER YEAR OF ECONOMIC EXPANSION FOR THE ROK. OFFICIAL PROJECTIONS ARE FOR REAL GROWTH BETWEEN 10-11 PERCENT; THE EMBASSY BELIEVES THE FINAL FIGURE MAY BE CLOSER TO THE LOWER ESTIMATE. EXPORTS ARE SLATED FOR A MODEST - FOR KOREA - 25 PERCENT GROWTH TO \$12.5 BILLION; AND DESPITE AN ACCELERATION OF IMPORTS THE CURRENT ACCOUNT SHOULD AGAIN SHOW A MODEST SURPLUS AS A RESULT OF SERVICE RECEIPT INFLOWS. THE PRINCIPAL ECONOMIC PROBLEM REMAINS MONETARY: HOW TO CONTROL THE RAPID GROWTH OF THE MONEY SUPPLY AND PREVENT INFLATIONARY FORCES FROM GETTING OUT OF HAND. ALTHOUGH THE OFFICIAL TARGET REMAINS 10 PERCENT, A 15 PERCENT INCREASE IN PRICES MAY BE THE BEST RESULT OBTAINABLE UNLESS THE GOVERNMENT RE-IMPOSES CONTROLS AND RESTRAINTS CREDIT, WHICH IN TURN COULD PLAY HAVOC WITH THE PROJECTED GROWTH RATES. END SUMMARY.

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1. AFTER THE COMPLETION OF ANOTHER SUCCESSFUL ECONOMIC PERFORMANCE IN 1977, THE ROK IS LOOKING FORWARD WITH RENEWED CONFIDENCE TO A REPEAT IN 1978. HIGH GROWTH REMAINS THE PRINCIPAL EMPHASIS WITH THE GNP TARGET SET WITHIN THE RANGE OF 10 TO 11 PERCENT. PER CAPITA GNP IN 1978 IS EXPECTED TO PASS THE THOUSAND DOLLAR BENCHMARK AND REACH 1,050 DOLLARS. EXPORTS, IN CURRENT PRICES, ARE TARGETED AT A 25 PERCENT

GROWTH RATE AT \$12.5 BILLION (CUSTOMS CLEARANCE BASIS) WITH IMPORTS, AS A RESULT OF RECENT LIBERALIZATION MEASURES, TO INCREASE SLIGHTLY MORE RAPIDLY TO \$13.2 BILLION. DESPITE THE SIZABLE TRADE DEFICIT, THE CURRENT ACCOUNT IS PROJECTED TO BE IN BALANCE AS A RESULT OF RECENT LIBERALIZATION MEASURES TO INCREASE SLIGHTLY MORE RAPIDLY TO \$13.2 BILLION. DESPITE THE SIZABLE TRADE DEFICIT, THE CURRENT ACCOUNT IS PROJECTED TO BE IN BALANCE AS A RESULT OF THE CONTINUING FLOW OF SERVICE RECEIPTS AND FOREIGN EXCHANGE RESERVES MAY REACH THE \$5 BILLION LEVEL. EVEN WITH A PROJECTED CUTBACK IN BORROWINGS ABROAD, THE BASIC BALANCE IN THE BOP IS FORECAST AT ABOUT \$1.0 BILLION.

2. OTHER GOALS SET FOR 1978 INCLUDE A DOMESTIC SAVINGS TARGET AT 2.5 TRILLION WON (\$5,165 MILLION), A LARGE 56 PERCENT INCREASE OVER THE 1977 TARGET WHICH WAS, IN FACT, EXCEEDED BY NEARLY 20 PERCENT. NEW SAVINGS PLANS ARE UNDER CONSIDERATION WITH APPROPRIATE ADJUSTMENTS IN INTEREST RATES. THE MONEY SUPPLY IS SLATED AT A 30 PERCENT GROWTH RATE, DOWN SOMEWHAT FROM THE 41 PERCENT GAIN REGISTERED IN 1977 BUT ABOVE THE 23 PERCENT RATE ORIGINALLY TARGETED IN THE FOURTH FIVE YEAR PLAN. AS APPEARS TO BE BECOMING STANDARD, THE INFLATION RATE -- WHOLESALE PRICES -- IS TO BE MAINTAINED AT THE 10 PERCENT LEVEL.

3. AS IN 1977 CONTROL OF THE MONEY SUPPLY AND DAMPENING LIMITED OFFICIAL USE

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INFLATIONARY PRESSURES APPEAR TO BE THE GOVERNMENT'S PRINCIPAL ECONOMIC POLICY ISSUE FOR 1978. ALTHOUGH, CONSIDERING THE RAPID RATE OF MONETARY GROWTH IN 1977, PRICE INCREASES WERE RELATIVELY RESTRAINED LAST YEAR, THIS WAS PRIMARILY THE RESULT OF A SYSTEM OF PRICE CONTROLS LAID OVER THE ECONOMY IN MID 1977 AND RIGID RESTRICTIONS ON CREDIT GROWTH. MOST OF THE FORMER HAVE OR ARE IN THE PROCESS OF BEING LIFTED; WHILE, AS A RESULT OF DIFFICULT FINANCIAL SITUATIONS FOR MANY BUSINESSES, CREDIT IS ALSO BEING GRADUALLY EASED. THE RAPID GROWTH OF THE MONETARY BASE AS A RESULT OF THE RAPID INFLUX OF FOREIGN ASSETS MAY BE SOMEWHAT REDUCED BY INCREASED IMPORTS AND RESTRICTIONS ON BORROWINGS ABROAD. HOWEVER, OTHER EXPANSIONARY FACTORS MAY TAKE UP SOME OF THE SLACK.

4. AT LEAST 150 BILLION WON (\$310 MILLION) OF GOVERNMENT FUNDS WILL BE RELEASED EARLY THIS YEAR TO PURCHASE RICE AS WELL AS INVESTMENT AND LOAN FUNDS FROZEN IN 1977 AS PART OF THE MONETARY STABILIZATION PROGRAM. IN FACT, THE OFFICIAL PROJECTIONS ARE FOR A DEFICIT IN THE GRAIN MANAGEMENT FUND OF NEARLY 600 BILLION WON (\$1,240 MILLION) FOR 1978, DOUBLE THAT RECORDED IN 1977. EVEN IF THE

GROWTH IN MONEY SUPPLY CAN BE HELD AT THE 30 PERCENT LEVEL, PRICES WILL RECEIVE AN UPWARD PUSH FROM SEVERAL OTHER SOURCES. ENERGY PRICES, WHICH HAVE BEEN HELD BELOW MARKET LEVEL THE PAST FEW YEARS, SHOULD INCREASE IN 1978. ALREADY THE PRICE OF COAL HAS BEEN BOOSTED 33.3 PERCENT AND INDICATIONS ARE THAT A 5 TO 6 PERCENT INCREASE IN OIL PRODUCT PRICES ARE IN THE OFFING. MOREOVER, WAGES IN 1977 IN MINING AND MANUFACTURING ROSE, ON THE AVERAGE OF 27.3 PERCENT. WITH SHORTAGES CROPPING UP IN THE LABOR MARKET, ESPECIALLY FOR SKILLED WORKERS, LARGE WAGE INCREASES MAY BECOME THE NORM AS EMPLOYERS SEEK TO OBTAIN, AND HOLD, THEIR LABOR FORCE.

5. IN GENERAL, BUSINESS IS CAUTIOUSLY OPTIMISTIC FOR 1978.
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THE CHAMBER OF COMMERCE, IN ITS BUSINESS PROSPECTS OUTLOOK FOR THE FIRST HALF, FORESEES A SEASONAL SLOWDOWN UNTIL FEBRUARY WITH RAPID GAINS THEREAFTER. GLASS, WOOD PRODUCTS, MACHINERY AND EQUIPMENT AND CHEMICAL PRODUCTS WERE SINGLED OUT AS ESPECIALLY PROMISING. INVESTMENT, HOWEVER, WILL BE CONCENTRATED IN REPLACING AND UPGRADING FACILITIES RATHER THAN EXPANSION. THE GENERAL TRADING COMPANIES ARE EVEN MORE OPTIMISTIC, WITH MOST RAISING THEIR EXPORT GOALS BY 40 PERCENT OR OVER COMPARED TO 1977 AND THE OFFICIAL EXPORT TARGET OF 25 PERCENT. DAEWOO HAS DOUBLED ITS TARGET TO ONE

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ACTION EA-12

INFO OCT-01 ISO-00 SP-02 USIA-06 AID-05 EB-08 NSC-05
TRSE-00 SS-15 STR-05 OMB-01 CEA-01 CIAE-00
COME-00 FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03
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BILLION DOLLARS WITH SAMSUNG AT \$700 MILLION AND ICC AT \$500 MILLION. ALTOGETHER THE GTC'S HAVE TARGETED EXPORTS AT \$4.7 BILLION OR 45 PERCENT OF TOTAL EXPORT VOLUME.

6. EMBASSY ASSESSMENT - PERHAPS THE EASIEST WOULD BE TO TAKE THE NATIONAL ECONOMIC GOALS AND FORECAST THAT THEY WILL, AT A MINIMUM, BE REACHED, IF NOT SURPASSED. OVER THE PAST SEVERAL YARS THIS HAS HELD TRUE IN MOST INSTANCES. DESPITE MAJOR DIFFICULTIES THE MAJOR GOALS FOR 1977 WERE ATTAINED, ALTHOUGH, AT LEAST ON THE PRICE FRONT, RESULTING IN SOME DISLOCATIONS AND STRAINS. THE EMBASSY FOREWAW THAT THE EXPORT AND GROWTH GOALS WOULD BE REACHED BUT HAD SOME DOUBTS ON THE PRICE OUTLOOK. IN ESSENCE, THIS IS OUR POSITION FOR 1978 WITH EVEN MORE DOUBTS AS TO THE AUTHORITIES' BEING ABLE TO RESTRAIN PRICE INCREASES WITHIN THE 10 PERCENT BENCHMARK.

7. UTILIZING VARIOUS ASSUMPTIONS, THE EMBASSY HAS PROJECTED GNP GROWTH, IN REAL TERMS, OF BETWEEN 9.3 PERCENT (LOW) TO 10.7 PERCENT (HIGH). IN ANY CASE, WE BELIEVE THAT THE RATE WILL BE CLOSER TO THE 10 ERCENT LEVEL THAN THE OFFICIAL HIGH LIMITED OFFICIAL USE

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OF 11 PERCENT. AGRICULTURAL GROWTH IN THE FIRST HALF SHOULD BE STRONG, AS MORE NORMAL WEATHER INCREASES PROSPECTS OF A GOOD BARLEY CROP COMPARED TO THE DROUGHT-INDUCED POOR HARVEST IN 1977. ON THE OTHER HAND, IT IS DOUBTFUL WHETHER THE EXCELLENT GAINS IN RICE PRODUCTION CAN BE DUPLICATED; THE GOVERNMENT IS ITSELF FORECASTING A MINIMAL 0.7 PERCENT GROWTH IN THIS AREA. AS A CONSEQUENCE AGRICULTURAL AND FISHERY SECTOR MAY GROW ABOUT 5 PERCENT, UP FROM THE 3.1 PERCENT GAIN REGISTERED IN 1977.

8. THE SECONDARY SECTOR OF MINING AND MANUFACTURING SHOULD DO SOMEWHAT BETTER THAN THE 11.2 GROWTH OF THE PAST YEAR, PROBABLY AROUND 13 PERCENT, WHILE THE SOCIAL OVERHEAD CAPITAL AND SERVICE SECTOR, WHICH WAS A LARGE CONTRIBUTOR TO THE EXCELLENT 1977 PERFORMANCE, WILL DROP SLIGHTLY TO ABOUT 10 PERCENT. THIS SECTOR MAY AGAIN BE THE KEY TO A HIGHER GROWTH RATE, IF HOUSING, AND GENERAL CONSTRUCTION ACTIVITIES CAN BE MAINTAINED AT PRESENT HIGH LEVELS. THE FORECAST IS FOR 240,000 HOUSES TO BE BUILT IN 1978, A 16.5 PERCENT GAIN. THIS SECTOR, HOWEVER, IS HIGHLY VOLATILE, DEPENDING ON CREDIT AVAILABILITIES AND SPECULATIVE ATTITUDES.

9. THE OFFICIAL \$12.5 BILLION EXPORT GOAL IS PROBABLY THE

MINIMUM EXPECTATION. AFTER DOWNTRENDING FOR MOST OF THE YEAR, L/C ARRIVALS SHOWED A RENEWED UPTREND IN THE FINAL QUARTER. (IT SHOULD BE NOTED THAT OFFICIAL PROJECTIONS AND COUNTS WILL BE ON THE CUSTOMS CLEARANCE BASIS RATHER THAN, AS FORMERLY, THE MCI SETTLEMENT BASIS, THUS GIVING A DOWNWARD BIAS TO THE EXPORT STATISTICS.) SOME PROJECTIONS HAVE GONE AS HIGH AS \$13 BILLION, AND IT APPEARS THAT \$12.7 BILLION MAY BE A REALISTIC FIGURE IF NO ADDITIONAL MAJOR TRADE BARRIERS ARE ERECTED AGAINST KOREAN EXPORTS. IMPORTS WILL RISE TO ABOUT \$13.2 BILLION, RESULTING IN A \$500 MILLION LIMITED OFFICIAL USE

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TRADE DEFICIT. THIS SHOULD BE BALANCED BY SERVICE RECEIPTS AND NET TRANSFERS, RESULTING IN ANOTHER SLIGHT CURRENT ACCOUNT SURPLUS OF UP TO \$100 MILLION. IF THERE IS A DEFICIT, IT WILL BE MINIMAL.

10 THE PRICE FRONT REMAINS THE MAJOR PROBLEM. EVEN IF THE GROWTH OF THE MONEY SUPPLY CAN BE HELD TO THE 30 PERCENT GOAL, AT BEST AN EVEN PROBABILITY, IT IS DIFFICULT TO FORESEE, IN THE ABSENCE OF CONTROLS, HOW PRICES CAN BE RESTRAINED AT THE 10 PERCENT LEVEL. WE BELIEVE THAT THE GOVERNMENT WILL BE FORTUNATE INDEED IF IT CAN HOLD WHOLESALE AND CONSUMER PRICE INCREASES BELOW 15 PERCENT IN THE COMING YEAR.

11. ALTHOUGH KOREA'S ECONOMY STILL REMAINS DEPENDENT ON THE FOREIGN SECTOR, IT HAS NOW REACHED THE STAGE WHERE INTERNAL DYNAMISM CAN CONTINUE ITS RAPID DEVELOPMENT, IN THE ABSENCE OF RANDOM SHOCKS, WITHOUT OVER RELIANCE ON THE EXTERNAL SECTOR FOR IMPETUS. DOMESTIC SAVINGS AND INVESTMENT ARE IN NEAR EQUILIBRIUM AND THERE IS AN INTERNAL MARKET WHICH IS READY FOR DEVELOPMENT AS INCOMES CONTINUE TO RISE. OVERSEAS CONSTRUCTION "EXPORTS" ARE BECOMING INCREASINGLY IMPORTANT; THE PROJECTION IS FOR \$4 BILLION IN NEW CONTRACTS IN 1978 COMPARED TO \$3.5 BILLION REGISTERED IN THE PAST YEAR. AS A CONSEQUENCE, THE CONTINUING SLOWDOWN IN GROWTH OF COMMODITY EXPORTS WILL NOT RESULT IN A DECELERATION OF GROWTH AS WOULD HAVE BEEN THE CASE IN PAST YEARS. IN ESSENCE, THE OUTLOOK REMAINS OPTIMISTIC AND WE EXPECT AT LEAST A 10 PERCENT REAL GROWTH FOR THE YEAR OF THE HORSE.
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